

WESTERN ASSET MANAGEMENT- US TIPS FULL DISCRETION
DOMESTIC FIXED: LEHMAN TIPS BENCHMARK

FOR THE MONTH OF: **SEPTEMBER** **2008**

MANAGER PERFORMANCE CALCULATIONS

** Annualized returns*

	Last <u>Month</u>	Last <u>3 Months</u>	Last <u>1 Year</u>	Last <u>3 Years*</u>	Last <u>5 Years*</u>
Western TIPS	-4.51%	-4.42%	4.91%	n/a	n/a
Lehman TIPS	-3.83%	-3.54%	6.20%	n/a	n/a

PERFORMANCE ATTRIBUTION & STRATEGY COMMENTS

Market Review—September 2008

The financial system came to a near halt this month as a series of dramatic events unfolded. The government took conservatorship of Fannie Mae and Freddie Mac. Lehman Brothers was unable to raise sufficient capital and filed for bankruptcy, and Barclays Capital then picked off choice assets. Merrill Lynch, sensing that its continued existence was in peril, arranged a deal with Bank of America. AIG was forced to seek government assistance to continue operations. The FDIC took over Washington Mutual and asked JPMorgan Chase to absorb the banking operations. Shortly thereafter, it brokered a tentative deal to sell parts of Wachovia to Citigroup. (Days after month end, this deal was challenged by a new Wells Fargo deal.) Several money market funds “broke the buck”, and stopped client redemptions. By the month’s end, Congress was debating a Treasury proposal to create a \$700 billion Troubled Asset Relief Program (TARP) to alleviate the financial system.

The TED spread, a measure of systemic lending risk, jumped over 200 bps to 315 bps as short-term lending froze.

Housing data released in the month did not show a turnaround. Existing home sales declined 2.2% and new home sales dropped 11.5% in August. The S&P/Case-Shiller Home Price Index showed a 16% yearly drop in home prices in July. In other data releases, core CPI inflation held steady at 2.5% while the headline measure was at 5.4%. The unemployment rate rose to 6.1% in September and initial jobless claims increased to 497,000. Oil prices continued to fall on expected lower demand, closing at \$100/barrel by month-end. Equity markets were weak as the S&P 500 and the Dow Jones lost 9% and 6% respectively. Equity volatility as measured by the VIX Index increased dramatically, and international equity performance was negative. The U.S. dollar was up near 2% against major currencies on a trade-weighted basis. Retail sales ex-autos showed negative growth (-0.70%) for the first time in six months. Treasuries rallied as investors sought a safe haven. Corporate bond spreads widened to historic highs on increased credit risk, while mortgage spreads narrowed as they benefited from the government intervention.

The Barclays TIPS Index generated a total monthly return of -3.94%, losing to its nominal counterpart by 4.55%. CPI accretion was moderate but lower inflation expectations caused a big sell-off in TIPS securities.

MANAGER STYLE SUMMARY

Western manages a Core Plus account in addition to this TIPS mandate. This is an expansion of our existing SSgA TIPS (Treasury Inflation Protected Securities) allocation in that this portfolio will be actively managed and will not employ a buy and hold strategy however, it will be more limited than what was our Bridgewater global TIPS portfolio. Western is limited to hold no more than 20% of the portfolio in non-inflation-linked bonds, but does have the latitude to hold foreign, non-dollar denominated securities, take currency positions, and enter into futures, options and swaps contracts, provided our daily pricing requirements are met..

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PORTFOLIO GUIDELINE COMPLIANCE

SEPTEMBER 2008

Portfolio Guideline:	Lehman TIPS	Western	Min	Max	Compliance
C2. Weighted average duration including futures	7.49		5.24	9.74	ok
Weighted average duration with options			5.99	8.99	ok
C3. Credit Quality					
(1) Rated securities: % invested in investment grade			80%	100%	ok
C4. Diversification					
(2a) Sector: % invested in IPS and/or floating rate securities			80%	100%	ok
(2b) Sector: % invested in US TIPS and/or floating rate securities			80%	100%	ok
(2c) Sector: % invested in non-IL bonds and MBS			0%	20%	ok
(2d) Sector: % invested in extended sectors including emg mkts			0%	20%	ok
Max invested in any one of the extended sectors					check
(2e) Sector: % invested in un-hedged non-dollar exposure			0%	15%	ok
(3a) Issuer: Limit of obligations of non-benchmark issuers			0%	5%	ok
(4) Credit: % invested in issues rated below Baa3 or BBB- / A2 or I			0%	20%	ok
(5) Derivatives: % invested in orig futures margin & option prem			0%	5%	ok
Max net credit derivative exposure (as % of mkt value)			0%	40%	ok
F2. Annual Turnover		54%	150%	250%	check
The portfolio is in compliance with all other aspects of the Portfolio Guidelines				<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No

MANAGER EXPLANATIONS FOR DEVIATIONS FROM PORTFOLIO GUIDELINES

C4. Diversification - Issuer:	As of 9/30/08, the concentration of Fannie Mae was at 5.069% due to market fluctuations.
C2. Duration:	Please note that Duration number reflects the Duration of the Portfolio, taking into account the duration contribution of BOTH Futures AND Options.
F2. Annual Turnover:	Given that TIPS' CPI accretion is based on the non-seasonally adjusted index, the tendency is for inflation to run high in the spring months and weak in the fall. As such, the real yield curve tends to steepen in spring and flatten in fall. Western generally adjusts our term structure to take advantage of this. However, given last year's Fed easing rates, we did not want to move out of short maturity TIPS into longer maturity TIPS like we usually do and thus traded less. As the real yield curve has continued in 2008 we have not yet changed position.

ORGANIZATIONAL/PERSONNEL CHANGES

During the third quarter of 2008, Western added no members to its investment team, while losing two portfolio managers (Jaroslaw K. Karpinski from Western's London office; and Valerie Bannon from Western's New York office); and one research analyst (Noriaki Matsui from Western's London office).

ACCOUNT TURNOVER

Gained:	Number of Accounts:	10	Total Market Value (\$m)	\$ 571.0
Lost:	Number of Accounts:	21	Total Market Value (\$m)	\$ 4,349.0
	Reason(s):	Please note this data excludes commingled fund participants, mandate transfers, and account contributions/withdrawals from existing clients. Data is PRELIMINARY and is subject to change; it represents information for the quarter ending September 30,		